

**The Internal Revenue Service Does Not
Penalize Employers that File Wage and Tax
Statements with Inaccurate Social Security
Numbers**

September 2002

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This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

INSPECTOR GENERAL
for TAX
ADMINISTRATION

September 11, 2002

MEMORANDUM FOR THE COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED
DIVISION

A handwritten signature in black ink, reading "Pamela J. Gardiner".

FROM: Pamela J. Gardiner
Deputy Inspector General for Audit

SUBJECT: Final Audit Report - The Internal Revenue Service Does Not
Penalize Employers that File Wage and Tax Statements with
Inaccurate Social Security Numbers (Audit # 200230002)

This report presents the results of our review to determine whether the Internal Revenue Service (IRS) addressed the Social Security Administration's (SSA) concerns about the accuracy of Social Security Numbers (SSN) provided by employers on Wage and Tax Statements (Form W-2).

In summary, we found that the SSA proposed in November 1998 that the IRS assist it with its compliance efforts by more strictly enforcing the "information return" penalty against employers that filed Forms W-2 with inaccurate name/SSN combinations.¹ Further, in August 2000 the SSA provided to the IRS a list of the most egregious non-compliant employers for Tax Years (TY) 1997 and 1998. The SSA provided this information so the IRS could determine whether penalties should be assessed.

However, the IRS does not penalize employers that file Forms W-2 with inaccurate name/SSN combinations, and the IRS has not developed a regularly scheduled program for administering the information return penalty law for these forms. Developing an information return penalty program became possible in approximately Calendar Year (CY) 1998. IRS management advised us that the IRS did not develop a

¹ Internal Revenue Code (I.R.C.) § 6721 (1999).

regularly scheduled program because of concerns about the level of resources needed to administer the program and the complexity of administration, weighed against the benefit that a program would have on tax administration.

With this perspective, the IRS did not determine whether penalties should be assessed against the most egregious non-compliant employers for TYs 1997 and 1998. As a result, the IRS did not propose and, subsequently assess when justified, an estimated \$26.0 to \$29.7 million in penalties against 93 employers for TY 1997 and 98 employers for TY 1998.²

On February 1, 2002, we issued a memorandum to IRS management (see Appendix VI). The memorandum stated that the IRS had not acted on the SSA's request and that the 3-year statute of limitations for assessing penalties for the TY 1998 documents would soon expire.³ We recommended that the IRS: (1) ascertain if penalties, when justified, could be assessed before the statute of limitations expired; (2) notify the SSA of its decision; and (3) meet with the SSA to jointly develop a method where the SSA can formally refer to the IRS the most egregious non-compliant employers for penalty consideration for TYs 1999 and 2000.

Also, during the review, we discussed with a representative of the Director, Office of Interest and Penalty Administration, Small Business/Self-Employed (SB/SE) Division, the need to initiate a regularly scheduled penalty program that would include all non-compliant employers.

In its response to our February 1, 2002 memorandum (see Appendix VII), the IRS determined that assessing penalties so close to the statute expiration date would be contrary to the IRS' due process procedures and could compromise taxpayers' rights. However, the IRS coordinated with the SSA to begin developing a penalty program for the most egregious non-compliant employers. The response also provided that the IRS will implement a separate, regularly scheduled penalty program beginning in CY 2004.

In addition to the recommendations already responded to, we also recommend that the Commissioner, SB/SE Division, prepare in conjunction with the SSA a document with the details of the joint IRS/SSA program designed for the most egregious non-compliant employers. We also recommend that the Director, Office of Interest and Penalty Administration, SB/SE Division ensure that the IRS propose, when justified, penalties against these employers following the provisions of I.R.C. § 6721, and develop a method for monitoring and analyzing the results of the programs.

Management's Response: The IRS agreed with our recommendations. The IRS plans to update an existing agreement with the SSA to address the Form W-2 process and exchange of information requirements. The IRS is developing guidelines and procedures for addressing the most egregious non-compliant employers and will use an

² The IRS includes 37 of the 98 employers identified for TY 1998 in its Large and Mid-Size Business Division. These employers have assets of \$10 million or more. The remaining 61 employers are in the IRS' Small Business/Self-Employed Division.

³ I.R.C. § 6501 (2001).

existing monitoring system to analyze the Form W-2 and Taxpayer Identification Number (TIN) Penalties. The IRS also advised that it is exploring the ramifications of not pursuing this area of non-compliance. Management's complete response to the draft report is included as Appendix VIII.

We estimated that if the IRS proposed penalties for TYs 1999 through 2001 against the same non-compliant employers identified for TYs 1997 and 1998, penalties of \$39 million would be proposed for up to 98 employers.⁴ (Appendix IV of this report provides a detailed description of these benefits.) However, the IRS did not agree that our recommendations would provide these measurable benefits on tax administration, citing tax laws that provide for the waiver of penalties for reasonable cause, including when errors relate to actions by the payee.

Office of Audit Comment: Subsequent to the conclusion of our review, the IRS provided assessment, waiver, and collection data for the TIN Penalty mail out for 1998. This penalty is similar to the penalty discussed in this report. The IRS waived 45.8 percent of the dollar amounts, but collected 16.7 percent of the assessed penalties. It should be noted that the estimate in our report is based on only 98 of the most egregious employers provided by the SSA – not the full universe of non-compliant employers. The number of egregious employers identified in the new program may be higher than those identified during our review, and therefore, the estimated amount of penalties may actually be higher than what we cited. Further, as we noted in our report, of all non-compliant employers for TYs 1997 and 1998, the SSA considered these employers as the most egregious, filing over 867,000 incorrect Forms W-2. While the volume of Forms W-2 involved is not the only non-compliance indicator, it does suggest the potential that at least some name/SSN mismatches are not "errors related to actions by the payee."

Copies of this report are also being sent to the IRS managers who are affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Gordon C. Milbourn III, Assistant Inspector General for Audit (Small Business & Corporate Programs), at (202) 622-3837.

⁴ The dollar figure represents the estimated amount of penalties that IRS could propose to assess against employers. Internal Revenue Code § 6724 (2001) provides that the IRS should waive a penalty if an employer can demonstrate that it had a reasonable cause for not meeting filing requirements.

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Background

Both the Social Security Administration (SSA) and the Internal Revenue Service (IRS) have roles in using and ensuring the accuracy of information provided on Wage and Tax Statements (Forms W-2). The SSA is required by law to maintain records of wages employers pay to employees. Employers report these wages annually to the SSA on Forms W-2. An estimated 250 million Forms W-2 were filed in 2001.

Along with other information, the Form W-2 includes the employee's name, Social Security number (SSN), and wages. The accurate reporting of name and SSN combinations is critical to enabling:

- The SSA to maintain accurate earnings records and calculate Social Security benefits.
- The IRS to ensure that information submitted by taxpayers is properly processed to the IRS' Master File¹ and to rely on the accuracy of Forms W-2 in programs to verify filing and reporting compliance with tax laws.²

When a Form W-2 name/SSN combination cannot be matched to the SSA's records, the SSA attempts to correct the information. If a correction cannot be made, the inaccurate record is controlled in a "suspense" file. As of 1999, this file included over 227 million records showing wages of over \$333 billion.³ Since 1990, this file has been increasing by an average of 5 million records and at least \$17 billion annually.

In a November 9, 1998 letter to the IRS, the SSA stated that it was undertaking a major initiative to improve the accuracy of employee name/SSN combinations. The SSA

¹ The Master File is the main IRS computer system that stores various types of taxpayer account information, including individual and business data.

² For example, the Automated Underreporter Program identifies wage earners that do not report all of their income on their U.S. Individual Income Tax Return (Form 1040). The program compares the income wage earners report on their Forms 1040 to the income reported by their employers on Forms W-2. If the documents do not match, the taxpayers could be contacted to explain the discrepancy.

³ Total accumulated from 1937 through 1999.

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proposed that the agencies work together to develop employer incentives that could encourage improved Form W-2 compliance. These employer incentives included the IRS more strictly enforcing the existing “information return” penalty against employers that did not submit accurate name/SSN combinations.⁴ The SSA is not authorized to assess this penalty and relies on the IRS to address information reporting compliance in this manner.

Further, in August 2000, the SSA provided to the IRS information on 93 employers who did not submit accurate employee name/SSN combinations on Forms W-2 for Tax Year (TY) 1997. The SSA also identified 98 employers for TY 1998. Of all non-compliant employers for TYs 1997 and 1998, the SSA considered these employers as the most egregious, filing over 867,000 incorrect Forms W-2. The SSA provided the information on the employers so the IRS could determine whether penalties should be assessed.

We performed this audit at the Small Business/Self-Employed (SB/SE) Division Headquarters in New Carrollton, Maryland, between December 2001 and April 2002. The audit was conducted in accordance with *Government Auditing Standards*. Detailed information about our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

The Internal Revenue Service Did Not Use Its Penalty Authority When Employers Filed Inaccurate Wage and Tax Statements

The Internal Revenue Code (I.R.C.) provides for a penalty against employers that do not file correct information returns, such as Form W-2. An inaccurate name/SSN combination is classified as an incorrect information return. The penalty is up to \$50 for each inaccurate return, while the total penalty imposed on an employer for 1 year cannot exceed \$250,000. The total penalty for a business with less than \$5 million in gross receipts is limited to \$100,000.⁵

The IRS’ policy on assessing penalties states that penalties are used to encourage voluntary compliance by: (1) helping taxpayers understand that compliant conduct is appropriate

⁴Internal Revenue Code § 6721 (1999). See Appendix V for a description of the information return penalty law.

⁵ I.R.C. § 6721 (1999); 26 CFR § 301.6721(g) (2001).

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and that non-compliant conduct is not; (2) deterring non-compliance by imposing costs on it; and (3) establishing the fairness of the tax system by justly penalizing the non-compliant taxpayer. Furthermore, an IRS Strategic Goal is to provide service to all taxpayers through fair and uniform application of the law.

However, the IRS does not penalize employers that file Forms W-2 with inaccurate name/SSN combinations. There are two main aspects of this problem.

The IRS has not developed a regularly scheduled program for administering the information return penalty law for Forms W-2 with incorrect name/SSN combinations

The IRS' computer files include the SSNs from Forms W-2 and the SSNs that the SSA provided to the IRS. However, the IRS does not compare the Form W-2 data to the SSN data to identify incorrect name/SSN combinations.

Consequently, employers against whom a penalty should be proposed are not identified.

IRS representatives advised us that a program was not practical before approximately 1998 because the IRS would have received the SSNs from the SSA after a critical IRS processing date had passed. The circumstances changed about 1998, and the data would have been received in time to establish a program. We did not estimate the number and dollar amount of the penalties that the IRS did not propose. This would entail developing a system to analyze millions of SSNs and Forms W-2; the universe of inaccurate wage reporting according to the SSA's records averages approximately 5 million Forms W-2 per year.

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The IRS did not determine whether penalties should be assessed against employers that the SSA identified as the most egregious non-compliers for TYs 1997 and 1998⁶

We advised the Commissioner, SB/SE Division on December 14, 2001 that the IRS had not taken substantive actions on the SSA's request to consider penalties against the most egregious non-compliant employers. Furthermore, the 3-year statute of limitations for assessing penalties for TY 1997 had expired, and the statute of limitations for TY 1998 was soon to expire on March 1, 2002.⁷

We followed-up this communication with a memorandum dated February 1, 2002 (see Appendix VI). We recommended that SB/SE Division's Acting Director, Compliance Policy immediately ascertain if penalty determinations could be made, and justified penalties assessed, before the TY 1998 statute of limitations expired. The Commissioner, SB/SE Division responded to the memorandum by stating that insufficient time remained before the statute expired to assess justified penalties. Making the assessments so close to the statute expiration date would be contrary to the IRS' due process procedures, possibly violate law, comprise taxpayers' rights, and create negative public relations (see Appendix VII).

The statute of limitations has now expired for TYs 1997 and 1998. Consequently, the IRS did not propose estimated penalties of between \$26.0 and \$29.7 million.⁸ For 1997, the IRS is legally barred from penalizing 93 employers for an estimated \$12.3 to \$13.6 million. The due date for TY 1997 Forms W-2 was March 2, 1998, so the 3-year

⁶ The IRS includes 37 of the 98 employers identified for TY 1998 in its Large and Mid-Size Business Division. These employers have assets of \$10 million or more. The remaining 61 employers are assigned to the SB/SE Division.

⁷ I.R.C. § 6501 (2000).

⁸ The dollar figures represent the estimated amount of penalties that IRS could propose to assess against employers. I.R.C. § 6724 (2001) provides that the IRS will waive a penalty if an employer can demonstrate that it had a reasonable cause for not meeting filing requirements.

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statute of limitations expired March 2, 2001.⁹ The IRS made no penalty determinations on 63 (67.7 percent) of the 93 cases, but did make determinations on the remaining 30 cases. However, these determinations were not made as a result of the SSA's request, and the determinations did not address inaccurate name/SSN combinations for Forms W-2. Rather, these determinations were most often for information return penalties for several types of Forms 1099, such as Miscellaneous Income (Form 1099-MISC) and Dividends and Distributions (Form 1099-DIV).

For 1998, the IRS is also legally barred from penalizing 98 employers for an estimated \$13.7 to \$16.1 million. The due date for these Forms W-2 was March 1, 1999, so the statute of limitations expired on March 1, 2002. The IRS made no penalty determinations on 72 (73.5 percent) of the 98 cases, while making determinations on the remaining 26 cases. These determinations were similar to the ones made for TY 1997.

We further recommended in the memorandum that the IRS, in conjunction with the SSA, develop a program for assessing penalties, when justified, against the most egregious non-compliant employers for TYs after 1998. The Commissioner, SB/SE Division responded by stating that the IRS will meet with the SSA to jointly develop a program, and a meeting was held in February 2002. The IRS' management advised us that they will continue to meet and work with SSA to develop a long-range plan to address the issues that have been identified. Areas that will be addressed include methods to ensure that employers have accurate SSNs and revisiting the criteria used by each agency to initiate contact with non-compliant employers.

The IRS' response also stated that action would be taken when the facts and circumstances show that the employer knowingly and willfully failed to comply with the requirements of I.R.C. § 6721. These actions may include correspondence with the employer, a telephone call or visit

⁹ I.R.C. § 6501. For returns filed by the due date (timely). The statute of limitations expires at a later date for any employer that filed after the due date.

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by an IRS representative, a proposed penalty assessment, and/or an examination.

We agree that the IRS should have at its disposal various tools to encourage compliance with the tax law. However, we do not agree with the standard that the IRS plans to use for taking action. I.R.C. § 6721 does not provide that an employer must “knowingly and willfully” violate the law for the penalty to be imposed. Rather, the law provides that an employer that files an incorrect information return “shall pay a penalty.”

Moreover during the review, we discussed with a representative of the Director, Office of Interest and Penalty Administration, SB/SE Division, the need to initiate a regularly scheduled penalty program that would include all non-compliant employers.

The Commissioner, SB/SE Division stated in the response to the memorandum that the IRS developed a process to incorporate missing and incorrect Forms W-2 into its “Missing and Incorrect [computer] program.”

Implementation is scheduled for Calendar Year 2004. Separately, the IRS advised us that this action would be the basis for a regularly scheduled compliance program, and that the 2002 tax year will be the first included in this program.

Why these problems occurred, and how they impact employers and the SSA

There were a number of causes for the IRS not having programs to penalize employers filing Forms W-2 with incorrect name/SSN combinations. IRS management advised us that the IRS did not develop a regularly scheduled program due to concerns about the level of resources needed to administer the program and the complexity of administration, weighed against the benefit a program would have on tax administration.

The IRS did not propose penalties in response to the SSA’s request for several reasons. Upon receiving the request, the IRS advised the SSA that it was reluctant to consider penalties until the SSA provided “specific and detailed information” on the depth of educational assistance given to

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the non-compliant employers. Subsequently, when the IRS initiated action on the request, the process was handled “informally,” and the IRS did not establish internal controls over the request process. In addition, the Commissioner, SB/SE Division stated, in his response to our memorandum, that the penalties were not proposed due to the IRS’ ongoing reorganization and lack of program resources.

By not assessing penalties, the IRS lost an opportunity to assist the SSA in its efforts to improve the accuracy of name/SSN combinations. Moreover, the IRS did not follow the I.R.C. or its penalty policy, or meet its Strategic Goal to apply laws fairly and uniformly. Specifically, the IRS:

- Did not impose penalties in a regularly scheduled penalty program from approximately 1998 to date.
- May have adversely affected its own operations. The IRS uses SSNs provided by the SSA to ensure that information submitted by taxpayers is properly processed to the IRS’ Master File.¹⁰ The IRS relies on the accuracy of Forms W-2 in programs to verify filing and reporting compliance with tax laws. The primary use is the Automated Underreporter Program.
- Treated employers differently. The IRS treated non-compliant employers the same as compliant employers by not providing a consequence for non-compliance. In addition, the IRS allowed non-compliant employers who file Forms W-2 to avoid the same type of penalty proposed against employers filing inaccurate Forms 1099. For example, the IRS might hypothetically propose a \$130,000 information return penalty against an employer for filing Forms 1099 with incorrect name/SSN combinations, while allowing a different employer to file Forms W-2 with the same problems and avoid a penalty.

In conclusion, the Joint Committee on Taxation (JCT) wrote that, “in the absence of penalties, the laws would, at best,

¹⁰ The Master File is the main IRS computer system that stores various types of taxpayer account information, including individual and business data.

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represent a suggested code of behavior. Anyone who disagreed with such code would be able to violate it without consequence.” The JCT also noted that most economic research has found that taxpayer compliance rises with the probability of enforcement, such as assessing penalties.¹¹

The SSA’s discussions with the employer community underscored the validity of the JCT’s statement. The discussions showed that there is no real incentive for the employers to improve the accuracy of the name/SSN reporting since there are no consequences that result from submitting inaccurate data.

The SSA relies on the IRS to provide consequences as an incentive to improve compliance. To this end, the IRS needs to penalize, when justified, employers that file Forms W-2 with inaccurate name/SSN combinations.

Recommendations

In conjunction with the IRS’ response to the memorandum dated February 1, 2002:

1. The Director, Office of Interest and Penalty Administration, SB/SE Division, should ensure that the IRS initiate, as proposed in their response to our memorandum, a regularly scheduled program for proposing penalties for Forms W-2 with inaccurate name/SSN combinations.

Management’s Response: The IRS is developing a program to incorporate missing and incorrect Forms W-2 into the Missing and Incorrect Taxpayer Identification Number Program and ensure Form W-2 compliance is integrated into the SB/SE Division’s program.

In conjunction with the recommendations addressed in the response to the memorandum:

¹¹ Study of Present-Law Penalty and Interest Provisions as Required by Section 3801 of the Internal Revenue Service Restructuring and Reform Act of 1998 (including provisions relating to corporate tax shelters), Volume I, July 22, 1999, pp. 30, 34.

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2. The Commissioner, SB/SE Division, should prepare a document describing the objective of the joint IRS/SSA program for the most egregious non-compliant employers, as well as the tasks, responsibilities, and agreements that are needed between the two agencies to meet the objective.

Management's Response: The SB/SE Division met with the SSA in February 2002 to jointly develop a program. The IRS will continue to meet and work with the SSA to develop a long-range objective. Also, the IRS will update an existing Memorandum of Understanding with the SSA to address the Form W-2 process and exchange of information requirements

3. The Director, Office of Interest and Penalty Administration, SB/SE Division, should ensure that the IRS propose, when justified, penalties against the most egregious non-compliant employers following the provisions of I.R.C. § 6721.

Management's Response: The IRS is updating Internal Revenue Manual 20.1, Chapter 7, Information Reporting Program. Additionally, the IRS will develop guidelines and procedures for working the most egregious non-compliant employers.

4. The Director, Office of Interest and Penalty Administration, SB/SE Division should develop a methodology for monitoring and analyzing the results of the regularly scheduled program and the joint IRS/SSA program for the most egregious non-compliant employers. The data available for monitoring should include the number and amount of penalties proposed, assessed, waived (and the reason for waiver), and collected. The data should also include the number of corrected Forms W-2 received in response to penalty actions.

Management's Response: The IRS developed a database of penalty information. This monitoring system will allow the IRS to analyze information relating to the imposition of penalties on non-compliant taxpayers. This system will also allow the IRS to analyze all Form W-2 and TIN penalties.

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Not connected with a specific recommendation, but in response to our outcome measure, the IRS did not agree that our recommendations would provide the reported measurable benefits on tax administration. The IRS cited tax laws that provide for the IRS waiving a penalty for reasonable cause, including when errors relate to actions by the payee. We estimated that if the IRS proposed penalties for TYs 1999 through 2001 against the same non-compliant employers identified for TYs 1997 and 1998, penalties of \$39 million would be proposed for up to 98 employers.¹² (Appendix IV of this report provides a detailed description of these benefits.)

Office of Audit Comment: Subsequent to the conclusion of our review, the IRS provided assessment, waiver, and collection data for the TIN Penalty mail out for 1998. This penalty is similar to the penalty discussed in this report. The IRS waived 45.8 percent of the dollar amount, but collected 16.7 percent of the assessed penalties. It should be noted that the estimate in our report is based on only 98 of the most egregious employers provided by the SSA – not the full universe of non-compliant employers. The number of egregious employers identified in the new program may be higher than those identified during our review, and therefore, the estimated amount of penalties may actually be higher than what we cited. Further, as we noted in our report, of all non-compliant employers for TYs 1997 and 1998, the SSA considered these employers as the most egregious, filing over 867,000 incorrect Forms W-2. While the volume of Forms W-2 involved is not the only non-compliance indicator, it does suggest the potential that at least some name/SSN mismatches are not "errors related to actions by the payee."

¹² The dollar figure represents the estimated amount of penalties that IRS could propose to assess against employers. I.R.C. § 6724 (2001) provides that the IRS should waive a penalty if an employer can demonstrate that it had a reasonable cause for not meeting filing requirements.

Detailed Objective, Scope, and Methodology

The overall objective of this review was to determine whether the Internal Revenue Service (IRS) addressed the Social Security Administration's (SSA) concerns about the accuracy of Social Security numbers (SSN) provided by employers on Wage and Tax Statements (Form W-2). To accomplish our overall objective, we:

- I. Determined whether the IRS considered proposing an information return penalty against the 93 employers for Tax Year (TY) 1997 and the 98 employers for TY 1998 that were identified by the SSA as the most egregious non-compliant employers for those years.
 - A. Determined whether the IRS had an action plan for controlling the request from the SSA.
 - B. Evaluated the IRS' actions to make penalty determinations and assess penalties.
 1. Interviewed managers and key personnel from the Office of the Director, Compliance Policy, Small Business/Self-Employed (SB/SE) Division and the Office of the Director, Compliance, Large and Mid-Sized Business Division.
 2. Evaluated correspondence between the IRS and the SSA.
 3. Determined the number of employers against whom the IRS should have proposed penalties and estimated the amount of the penalties by:
 - a) Analyzing tax information in the IRS' Master File.¹
 - b) Applying the Internal Revenue Code (I.R.C.) and the Code of Federal Regulations (CFR) rules for computing the penalty.²
 4. Reviewed reports issued by the Office of the Inspector General, SSA.
 5. Interviewed the SSA's Senior Financial Executive.
- II. Determined whether the IRS had a regularly scheduled program for assessing the information return penalty against employers filing Forms W-2 with incorrect name/SSN combinations.
 - A. Interviewed managers and key personnel from the Office of the Director, Compliance Policy, SB/SE Division, and the Office of Modernization, Information Technology & Security Services.

¹The Master File is the IRS' main computer system that stores various types of taxpayer account information, including individual and business data.

² See Appendix IV, Outcome Measures, for the methodology used to make this determination.

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- B. Evaluated penalty processing procedures included in the Internal Revenue Manual.
- C. Evaluated computer Programming Requirement Packages related to the IRS information penalty program.³
- D. Evaluated a Request for Information Services for the IRS information return penalty program.⁴
- E. Reviewed statistics included in the Enforcement Revenue Information System, Penalty Report-National for Fiscal Year 2001.

³ The Program Requirements Package shows data specifications and related processing criteria required for the development and documentation of computer programs.

⁴ The Request for Information Services is used to request changes to current and planned computer systems.

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Appendix II

Major Contributors to This Report

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Appendix III

Report Distribution List

Commissioner N:C
Deputy Commissioner N:DC
Commissioner, Large and Mid-Size Business Division LM
Deputy Commissioner, Small Business/Self-Employed Division S:DC
Director, Compliance Policy, Small Business/Self-Employed Division S:C
Director, Taxpayer Education and Communication, Small Business/Self-Employed Division S:T
Chief Counsel CC
National Taxpayer Advocate TA
Director, Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis N:ADC:R:O
Office of Management Controls N:CFO:F:M
Audit Liaisons:
 Commissioner, Small Business/Self-Employed Division S
 Commissioner, Large and Mid-Size Business Division LM
 Director, Compliance Policy, Small Business/Self-Employed Division S:C

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Appendix IV

Outcome Measures

This appendix presents detailed information on the measurable impact that our recommended corrective actions will have on tax administration. These benefits will be incorporated into our Semiannual Report to the Congress.

Type and Value of Outcome Measure:

- Increased Revenue – Potential; \$39 million (see page 2).¹

Methodology Used to Measure the Reported Benefit:

We determined the number of employers that submitted to the Social Security Administration (SSA) incorrect Wage and Tax Statements (Forms W-2), and whom the SSA identified to the Internal Revenue Service (IRS) in August 2000. The SSA identified 93 employers for Tax Year (TY) 1997 and 98 employers for TY 1998.²

We computed for each employer an initial estimate of the information return penalty by multiplying the number of incorrect Forms W-2 by the penalty amount of \$50 per form. We determined the amount of any information return penalty that the IRS previously proposed and adjusted the initial estimate by this amount. The result was the maximum amount of additional penalty that could be proposed, unless this amount was greater than the maximum allowed by law.³

To determine whether an employer qualified for a maximum penalty of \$100,000, we computed the average amount of gross receipts for the 3 TYs, as provided by I.R.C. § 6721. For TY 1997 returns, we used TYs 1995 to 1997. For TY 1998 returns, we used TYs 1996 to 1998. The maximum penalties are:

- \$100,000 for employers having an average amount of receipts equal to or less than \$5 million.
- \$250,000 for employers having an average amount of receipts of greater than \$5 million.

¹ This amount represents the estimated amount of penalties that IRS could propose to assess against employers. Internal Revenue Code (I.R.C.) § 6724 (2001) provides that the IRS should waive a penalty if an employer can demonstrate that it had a reasonable cause for not meeting filing requirements.

² The SSA's list also included TY 1996. I.R.C. § 6501(2001) provides for a 3-year statute of limitations for assessing penalties. This statute had expired before the date of the list. Consequently, the IRS had no opportunity to determine if penalties should be assessed. Therefore, we did not include TY 1996 in our computation. Appendix V, Summary of the Laws Referred to in this Report, includes a more detailed explanation of these laws.

³ I.R.C. § 6721(1999) and the Code of Federal Regulations § 301.6721 (2001) provide for penalties of up to \$50 per incorrect form and an overall penalty limitation for all incorrect forms of either \$100,000 or \$250,000, depending on the employer's average amount of gross receipts for a 3-year period.

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- \$100,000 for employers for whom the average amount of gross receipts could not be computed.⁴ We used this amount to ensure that our estimate was conservative.

We computed the value of the outcome measure by adding the potential penalties for TY 1997 and TY 1998 (\$12.3 million + \$13.7 million = \$26.0 million). Then, we divided the sum by 2 to obtain the average penalty for the 2 TYs (\$26.0 million / 2 = \$13.0 million). Finally, we multiplied the average by 3, to obtain the estimate of penalties for a 3-year period (\$13.0 million x 3 = \$39.0 million). The 3-year period represents TYs 1999, 2000, and 2001, for which the IRS and the SSA are developing a program to identify and potentially penalize the most egregious non-compliant employers. The estimate assumes that the same employers that were identified for TY 1997 and 1998 would be identified for TYs 1999 through 2001.

⁴The IRS' Master File did not include gross receipts for these employers. The Master File is the IRS' main computer system that stores various types of taxpayer account information, including individual and business data.

Statutes Referred to in this Report

I.R.C. § 6721

This Internal Revenue Code (I.R.C.) section provides that a person is subject to a penalty when that person fails to file an information return on or before the required filing date, and fails to include all of the information required to be shown on the return or the inclusion of incorrect information. The penalty is up to \$50 for each return with respect to which such a failure occurs, but the total amount imposed on such person for all such failures during any calendar year shall not exceed \$250,000. The failures subject to penalty include any failure to file an information return with the Secretary on or before the required filing date, and any failure to include all of the information required to be shown on the return or the inclusion of incorrect information.

The I.R.C. also provides lower limitations for persons with gross receipts of not more than \$5 million. If any person meets the gross receipts test with respect to any calendar year, with respect to failures during such taxable year, the limit will be \$100,000 rather than \$250,000. The gross receipts test is met when, for any calendar year, the average annual gross receipts of such person for the most recent 3 taxable years ending before such calendar year do not exceed \$5 million. I.R.C. § 448 provides additional clarification. The gross receipts for any taxable year shall be reduced by returns and allowances made during such year. Income tax returns, such as the U.S. Corporation Income Tax Return (Form 1120), show the amount as “net receipts.” In addition, any references to an entity shall include a reference to any predecessor of such entity.

CFR 301.6721

This Code of Federal Regulations (CFR) section provides that no more than one penalty will be imposed with respect to a single information return even though there may be more than one failure with respect to such return. It also states that errors or omissions that are never inconsequential include a taxpayer identification number, a surname of the person required to be furnished a copy of the information set forth on an information return, and any monetary amounts. In addition, the CFR includes as examples of “information returns” Form 1099-MISC, Form W-2, and Form 1099-INT.

I.R.C. § 6501

This I.R.C. section provides that the amount of any tax imposed shall be assessed within 3 years after the return was filed (whether or not such return was filed on or after the date prescribed), and no proceeding in court without assessment for the collection of such tax shall be begun after the expiration of such period.

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I.R.C. § 6724

The I.R.C. section provides that no penalty shall be imposed under this part with respect to any failure if it is shown that such failure is due to reasonable cause and not to willful neglect. The CFR 301.6724 provides that reasonable cause occurs if the filer establishes that either (1) there are significant mitigating factors with respect to the failure or (2) the failure arose from events beyond the filer's control. Also, filers must establish that they acted in a responsible manner both before and after the failure occurred.

The Internal Revenue Service Does Not Penalize Employers that File Wage and Tax Statements with Inaccurate Social Security Numbers

Appendix VI

Memorandum: The Statute of Limitations for Assessing Penalties Against Employers Providing Incorrect Annual Wage Report Information to the Social Security Administration for Tax Year 1998 Will Expire on March 1, 2002



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

February 1, 2002

Response Date
February 18, 2002

MEMORANDUM FOR COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED DIVISION

FROM: *Gordon C. Milbourn III*
Gordon C. Milbourn III
Assistant Inspector General for Audit (Small Business &
Corporate Programs)

SUBJECT: The Statute of Limitations for Assessing Penalties Against
Employers Providing Incorrect Annual Wage Report
Information to the Social Security Administration for Tax
Year 1998 Will Expire on March 1, 2002

The purpose of this memorandum is to advise you of a significant issue requiring immediate attention. This issue concerns the imminent expiration of the 3-year statute of limitations for assessing information return penalties against non-compliant employers filing Wage and Tax Statements (Forms W-2) for Tax Year (TY) 1998.

These employers reported employee name and Social Security Number (SSN) combinations on their Forms W-2 that did not match the Social Security Administration's (SSA) records. In August 2000, the SSA referred a listing of the 98 most egregiously non-compliant employers for TYs 1997 and 1998 to the Internal Revenue Service (IRS).¹

The IRS needs to determine if sufficient time remains to assess any justified penalties before the TY 1998 statute of limitations expires on March 1, 2002. We estimate that at least \$9.3 million in potential assessments is at risk. The statute of limitations for the TY 1997 has already expired, and the IRS did not determine if penalties of at least \$8.7 million were justified.²

We identified this issue during our review entitled *Internal Revenue Service Penalty Determinations on Employers Providing Incorrect Annual Wage Report*

¹ The SSA also provided data for TY 1996. However, the statute for 1996 had expired before the SSA provided the data to the IRS.

² The dollar estimates are preliminary. Revised estimates will be provided in the report.

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Information to the Social Security Administration (Audit #200230002). We discussed this issue with: the Small Business/Self-Employed (SB/SE) Division Program Manager, Employment Tax; the Large and Mid-Size Business Division Employment Tax National Program Manager; and representatives of the Office of Chief Counsel and the Office of Penalty and Interest Administration.

Please provide your written response to this memorandum by the date shown above. Please include an assessment of the cause, the proposed corrective action, the completion date of the proposed corrective action, the responsible management official, and the plan and methodology for tracking and ensuring the effectiveness of the corrective action. If you disagree with any of the facts as presented in this memorandum, or if you would like to meet to discuss these issues, please contact me, or Philip Shropshire, Director (Corporate and Customer Service Programs), at (215) 516-2341.

Background

The SSA is required by law to maintain records of wages employers pay to employees. Employers report these wages to the SSA annually on Forms W-2. When the information reported by employers cannot be matched to SSA records, the SSA attempts to perfect the information.

In a letter to the IRS dated November 9, 1998, the SSA stated that it was undertaking a major initiative to improve the accuracy of employee names and SSNs reported on Forms W-2. A proposal was made that the SSA and the IRS work together to develop employer incentives that could encourage improved compliance. These incentives included the IRS more strictly enforcing existing civil penalty provisions. The SSA is not authorized to assess penalties against non-compliant employers and must rely on the IRS to help deter non-compliance.

The Internal Revenue Code (IRC) and related regulations provide that a penalty of \$50 is imposed for each Form W-2 when an employer does not include the required SSN and employee name, or the employer does not include the correct SSN and name. The total penalty imposed on an employer for a calendar year cannot exceed \$250,000. The total penalty for an employer with gross receipts of not more than \$5 million is \$100,000.³

In August 2000, the SSA provided to the IRS information on 98 employers who did not submit accurate employee name/SSN information on Forms W-2 for TY 1998. The SSA also identified 93 employers for TY 1997. Of all non-compliant employers for TYs 1998 and 1997, the SSA considered these employers as the most egregious, filing over 867,000 incorrect Forms W-2. The SSA provided the information on the 98 employers so the IRS could explore the possibility of assessing penalties.

³ L.R.C. 6721 (1999), Treas. Reg. 301.6721 (2001)

The Internal Revenue Service Does Not Penalize Employers that File Wage and Tax Statements with Inaccurate Social Security Numbers

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Results

The IRC provides that the amount of any tax shall be assessed within three years after the return was filed (whether or not the return was filed on or after the due date), and no proceeding in court without assessment for the collection of the tax shall be begun after this period expires.⁴ The IRC also provides that this statute of limitations applies to assessments for the information return penalty.

The IRS did not determine whether penalties should be assessed against the non-compliant employers, as follows.

- TY 1998: The IRS will soon be legally barred from making assessments on timely filed Forms W-2 for TY 1998. The due date for these Forms W-2 was March 1, 1999, so the statute of limitations will expire on March 1, 2002. The IRS made no information return penalty determination on 71 of the 98 cases (72.4 percent). The IRS made a determination on the remaining 27 cases. However, the determinations were not made as a result of the referral, and the determinations did not address inaccurate SSN/name combinations for Forms W-2. Rather, these determinations were most often for information return penalties for several types of Forms 1099, such as Miscellaneous Income (Form 1099-MISC) and Dividends and Distributions (Form 1099-DIV). Unless it takes immediate action, the IRS will be barred from assessing penalties of between an estimated \$9.3 and \$17.2 million.
- TY 1997: The IRS was legally barred from assessing the penalty on 93 cases approximately 6 months after the SSA identified to the IRS the non-compliant employers, in August 2000. The due date for TY 1997 Forms W-2 was March 2, 1998, so the 3-year statute of limitations expired March 2, 2001. The IRS made no information return penalty determination on 63 of the 93 cases (67.7 percent). The IRS made a determination on the remaining 30 cases. However, the determinations were similar to those made for TY 1998, were not made as a result of the referral, and did not address inaccurate SSN/name combinations for Forms W-2. As a result of not taking timely actions, we estimate that the IRS is barred from assessing penalties of between \$8.7 and \$14.2 million.

Making penalty determinations and assessing justified penalties is consistent with one of the IRS' Strategic Objectives: service to all taxpayers through fair and uniform application of the law. The IRS will soon be barred from penalizing the 98 non-compliant employers. As a result, the IRS would be treating those employers the same as employers that file accurate information. Also, the IRS would be treating these employers advantageously, as compared with employers who have been penalized for information reporting non-compliance.

The IRS needs to follow its penalty policy. The IRS also needs to communicate with the employers to help them understand that their conduct is not appropriate

The Internal Revenue Service Does Not Penalize Employers that File Wage and Tax Statements with Inaccurate Social Security Numbers

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and deter noncompliance by imposing costs on it. Moreover, the IRS needs to provide to the SSA the assistance that it requested in meeting the SSA's objective of improving the compliance of employers who file Forms W-2.

The statute of limitations expired, or is in jeopardy of expiring, because the IRS handled the referrals "informally," and did not implement internal controls to ensure that penalty determinations were considered. The IRS took no substantive action for the 17 months between the time of the referral in August 2000 and the date of this memorandum.

Recommendations

The Acting Director, Compliance Policy, SB/SE Division needs to:

1. Immediately ascertain if penalty determinations can be made and justified penalties can be assessed before the TY 1998 statute of limitations expires.
2. Immediately notify the SSA of the outcome of this decision.
3. Meet with the SSA to develop a program within which the SSA can formally refer to the IRS the most egregious non-compliant employers for TYs 1999 and 2000. This program should require the IRS to assess justified penalties before the statute of limitations expires.

**The Internal Revenue Service Does Not Penalize Employers that File
Wage and Tax Statements with Inaccurate Social Security Numbers**

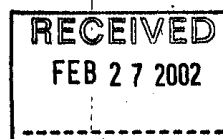
Appendix VII

Management's Response to Memorandum



**DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224**

FEB 27 2002



**MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDIT
(SMALL BUSINESS & CORPORATE PROGRAMS)**

FROM:

gn Joseph G. Kehoe *John F. Kehoe*
Commissioner, Small Business/Self-Employed Division

SUBJECT:

The Statute of Limitations for Assessing Penalties Against
Employers Providing Incorrect Annual Wage Report
Information to the Social Security Administration for Tax
Year 1998 Will Expire on March 1, 2002 (Audit No.
200230002)

I have reviewed your memorandum dated February 1, 2002, which provided information on a problem faced by the Social Security Administration (SSA). The SSA is unable to match social security data with the correct employees because employers are providing incorrect W-2 information. The SSA has asked that the IRS encourage employers to provide correct information by enforcing the penalty provisions of the Internal Revenue Code. Your memorandum recommended that the IRS take three actions:

- Determine if penalties should be assessed against 98 of the most egregious non-compliant employers for TY 1998.
- Inform the SSA of our decision.
- Meet with the SSA to develop a formal program that the SSA can use to refer non-compliant employers.

The Internal Revenue Code and related regulations allow the IRS to charge a penalty of \$50.00 for each Form W-2 when an employer does not include the employee's name and/or Social Security Number (SSN), or includes the incorrect SSN and/or name.

We have determined that insufficient time remains to assess justified penalties on the TY 1998 cases before the statute of limitations expires on March 1, 2002. Penalty assessments at this time would be contrary to the Internal Revenue Service's due process procedures. Such assessments also could possibly violate Section 1203 of the IRS Restructuring Act of 1998, compromise taxpayers' rights, and create negative public relations.

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Accordingly, we contacted Mr. Norman Goldstein, Senior Financial Manager, of the SSA, to tell him that we will not be taking further action on the TY 1998 cases. However, we will meet with Mr. Goldstein and his staff to develop a program the SSA can use to refer the most egregiously non-compliant employers for TYs 1999 and 2000 to the IRS. We also will analyze all data provided by the SSA for TYs 1997 through 2000 to work with the non-compliant employers who file incorrect information returns. The following action plan addresses your specific recommendations in more detail:

Recommendation 1:

The Acting Director, Compliance Policy, SB/SE Division should immediately ascertain if penalty determinations can be made and justified penalties can be assessed before the TY 1998 statute of limitations expires.

Assessment of Cause:

In August 2000, the SSA provided the IRS information on 98 employers who did not submit accurate employee name/SSN information on Forms W-2 for TY 1998. The SSA also identified 93 employers for TY 1997. The IRS was unable to provide the SSA with the requested assistance due to the ongoing reorganization and the lack of program resources.

Corrective Action:

We have determined that insufficient time remains to assess any justified penalties on the TY 1998 cases before the statute of limitations expires on March 1, 2002. However, we will continue to work with SSA to develop a program where the SSA can refer the most egregiously non-compliant employers, as well as identify other non-compliant employers.

Additionally, the Office of Penalty and Interest Administration has developed a process to incorporate Missing and Incorrect W-2s into the Missing and Incorrect TIN Program. A Request for Information Services (RIS) was submitted on January 31, 2002. The implementation date of the RIS is March 1, 2004.

The Office of Penalty and Interest Administration is also working closely with Service Center Operations to determine where the program can be administered most effectively and efficiently.

Implementation Date:

Completed: February 5, 2002

Responsible Official:

Acting Director, Compliance Policy, SB/SE Division

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Corrective Action Monitoring Plan:

None.

Recommendation 2:

The Acting Director, Compliance Policy, SB/SE should immediately notify the SSA of the outcome of this decision.

Assessment of Cause

The statute of limitations for assessing information return penalties against the Social Security Administration's egregiously non-compliant employers for TY 1998 will expire on March 1, 2002.

Corrective Action:

The Headquarters' Program Manager, Employment Tax, contacted the Senior Financial Manager of Social Security Administration, on February 5, 2002, to tell him that the IRS will not be assessing any information return penalties on the non-compliant employers for TY 1998 because of the imminent statute expiration.

Implementation Date:

Completed: February 5, 2002

Responsible Official(s):

Acting Director, Compliance Policy, SB/SE Division

Corrective Action Monitoring Plan:

None.

Recommendation 3:

The Acting Director, Compliance Policy, SB/SE Division should meet with the SSA to develop a program within which the SSA can formally refer to the IRS the most egregious non-compliant employers for TYs 1999 and 2000. This program should require the IRS to assess justified penalties before the statute of limitations expires.

Assessment of Cause:

The law requires the SSA to maintain records of wages employers pay to employees. Employers report these wages to the SSA annually on Forms W-2. When the SSA cannot match information reported by employers to SSA records, the SSA attempts to correct the W-2 information. The SSA cannot assess penalties against non-compliant employers and must rely on the IRS to do so.

The Internal Revenue Service Does Not Penalize Employers that File Wage and Tax Statements with Inaccurate Social Security Numbers

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Corrective Action:

We met with the SSA on February 12, 2002, to begin the process of developing a program the SSA can use to refer to us the most egregious non-compliant employers for TYs 1999 and 2000.

We will use the data gathered for TYs 1997 through 2000 as follows:

1. Analyze and develop a list of the most egregiously non-compliant employers for TYs 1997, 1998, 1999 and 2000. This will be completed within 120 days from the receipt of the 1999 and 2000 data from SSA.
2. Develop a contact letter to notify the most egregiously non-compliant employers of their responsibility to file correct information returns. This will be completed within 60 days from the date of this letter.
3. Take corrective actions when the facts and circumstances show the employer knowingly or willfully failed to comply with the requirements of section 6721 of the Revenue Code. Corrective actions may include another letter, a phone call or visit by an IRS representative, a proposed penalty assessment and/or an examination.

Implementation Date:

Item #1 - to be completed 120 days from the receipt of the 1999 and 2000 data.

Item #2 - to be completed by May 26th, 2002, or 90 days from the date of this letter.

Item #3 - these actions will be taken continuously until all issues have been resolved, but no later than the statute of limitation period ending March 1, 2004.

Responsible Official(s):

Acting Director, Compliance Policy, SB/SE Division

Corrective Action Monitoring Plan:

The Program Manager for the Office of Penalties and Interest, within Compliance Policy, will monitor and update SB/SE Management of any delay, change, or problem with the implementation.

If you have any questions, please contact Martha Sullivan, Director, Compliance, Small Business/Self-Employed at (202)-283-2144.

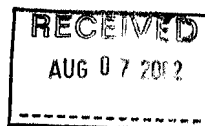
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Appendix VIII

Management's Response to the Draft Report



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224



AUG - 5 2002

MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Joseph G. Kehoe
Commissioner, Small Business/Self-Employed Division

SUBJECT: Draft Audit Report – The Internal Revenue Service Does Not Penalize Employers that File Wage and Tax Statements with Inaccurate Social Security Numbers (Audit # 200230002)

I have reviewed the draft report and generally agree with your recommendations. We strive to treat all taxpayers equally. We agree we should apply the provisions of Section 6721 of the Internal Revenue Code when employers submit incorrect or missing Social Security Numbers (SSNs) on Forms W-3 to the Social Security Administration (SSA).

We know we need to develop a program or system that would identify and penalize employers who consistently provide incorrect information reporting documents. We previously decided such a program would not be feasible because we lacked resources and the program was too complex to administer.

We are exploring the ramifications of not pursuing this area of noncompliance and have committed resources to addressing the viability of incorporating the W-2 concept with our Incorrect/Missing 1099 Program.

In Appendix IV, Outcome Measures, of your report, you estimate we could collect \$39 million in additional revenue if we assessed an information return penalty against all employers who were the subject of this report. We do not agree with your estimate or the methodology you used in calculating it. We are concerned your report implies that all employers whose W-2s contain mismatched SSN information have not acted with due diligence. Section 6724 of the Internal Revenue Code provides for waiver of penalty for reasonable cause. Section 301.6724-1(c)(v) provides relief when the errors relate to actions by the payee.

In an employer/employee relationship, the employer relies on the information provided by the employee on a Form W-4. If an employer used information provided on a properly executed Form W-4, then we would waive assessment of the penalty. Additionally, Regulation 31.3402(f)(2)-1 states an employer should

The Internal Revenue Service Does Not Penalize Employers that File Wage and Tax Statements with Inaccurate Social Security Numbers

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withhold as if the employee is single with zero withholding exemptions, if the employee does not provide the information as required in the Form W-4.

In view of these facts, it is highly unlikely that \$39 million in information penalty assessments would be sustained.

Our responses to your recommendations are as follows:

RECOMMENDATION 1

The Director, Office of Penalties and Interest, SB/SE Division, should ensure that the IRS initiates a regularly scheduled program for proposing penalties for Forms W-2 with inaccurate name/SSN combinations.

ASSESSMENT OF CAUSE

We did not develop a regularly scheduled program because of concerns about the level of resources needed to administer the program and the complexity of administration.

CORRECTIVE ACTIONS

The Office of Penalties and Interest, SB/SE Division, is developing a program to:

- (1) Incorporate Missing and Incorrect W-2s into the Missing and Incorrect TIN Program, and
- (2) Ensure W-2 compliance is integrated into the SB/SE program.

IMPLEMENTATION DATE

July 2004

RESPONSIBLE OFFICIAL

Director, Reporting Enforcement, Small Business/Self-Employed Division

CORRECTIVE ACTION MONITORING PLAN

The Director, Office of Penalties and Interest, within Reporting Enforcement, will monitor and update SB/SE Management of any delay, change, or problem with the implementation.

RECOMMENDATION 2

The Commissioner, SB/SE Division, should prepare a document describing the objective of the joint IRS/SSA program for the most egregious non-compliant employers, as well as the tasks, responsibilities, and agreements that are needed between the two agencies to meet the objective.

ASSESSMENT OF CAUSE

In a November 1998 letter to the IRS, the SSA stated it was undertaking a major initiative to improve the accuracy of employee name/SSN combinations. The

The Internal Revenue Service Does Not Penalize Employers that File Wage and Tax Statements with Inaccurate Social Security Numbers

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SSA proposed the agencies work together to develop employer incentives that would encourage improved Form W-2 compliance. We advised the SSA we were reluctant to consider penalties until the SSA provided specific and detailed information on the depth of educational assistance given to the non-compliant employers.

CORRECTIVE ACTIONS

The SB/SE Division met with SSA in February 2002 to jointly develop a program. We will continue to meet and work with SSA to develop a long-range objective.

We are also updating an existing Memorandum of Understanding with SSA to address the Form W-2 process and exchange of information requirements.

IMPLEMENTATION DATE

January 2003

RESPONSIBLE OFFICIAL

Director, Reporting Enforcement, Small Business/Self-Employed Division.

CORRECTIVE ACTION MONITORING PLAN

The Director, Office of Penalties and Interest, within Reporting Enforcement, will monitor and update SB/SE Management of any delay, change, or problem with the implementation.

RECOMMENDATION 3

The Director, Office of Penalties and Interest, SB/SE Division, should ensure that the IRS propose, when justified, penalties against the most egregious noncompliant employers following the provisions of I.R.C. Section 6721.

ASSESSMENT OF CAUSE

We do not have a system in place to ensure that we assess penalties against employers who knowingly and willfully failed to comply with the requirements of Section 6721 of the Internal Revenue Code.

CORRECTIVE ACTIONS

The Office of Penalties and Interest is updating Internal Revenue Manual 20.1, Chapter 7, Information Reporting Program. Additionally, we will develop guidelines and procedures for working the most egregious non-compliant employers.

IMPLEMENTATION DATE

December 2002

RESPONSIBLE OFFICIAL

Director, Reporting Enforcement, Small Business/Self-Employed Division.

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CORRECTIVE ACTION MONITORING PLAN

The Director, Office of Penalties and Interest, within Reporting Enforcement, will monitor and update SB/SE Management of any delay, change, or problem with the implementation.

RECOMMENDATION 4

The Director, Office of Penalties and Interest, should develop a methodology for monitoring and analyzing the results of the regularly scheduled program and the joint IRS/SSA program for the most egregious non-compliant employers. The data available for monitoring should include the number and amount of penalties proposed, assessed, waived (and the reason for waiver), and collected. The data should also include the number of corrected Forms W-2 received in response to penalty actions.

ASSESSMENT OF CAUSE

Because we do not have a program in place, we cannot determine the effect of penalty administration on non-compliant employers who issue incorrect Forms W-2.

CORRECTION ACTIONS

We developed a database of penalty information for the Office of Penalties and Interest. This monitoring system will allow us to analyze information relating to the imposition of penalties on non-compliant taxpayers. This system will also allow us to analyze all Form W-2 and TIN penalties.

IMPLEMENTATION DATE

December 2002

RESPONSIBLE OFFICIAL

Director, Reporting Enforcement, Small Business/Self-Employed Division.

CORRECTIVE ACTION MONITORING PLAN

The Director, Office of Penalties and Interest, within Reporting Enforcement, will monitor and update SB/SE Management of any delay, change, or problem with the implementation.

If you have any questions, please call me at (202) 622-0600, or Joseph R. Brimacombe, Deputy Director, Compliance Policy, Small Business/Self-Employed Division, at (202) 283-2200.